State Notes

TOPICS OF LEGISLATIVE INTEREST

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Senate Fiscal Agency

Michigan's Farm Disaster Relief Program
by Craig Thiel, Fiscal Analyst

Introduction

In December 2001, 82 of the 83 Michigan counties (Keweenaw excluded) received Federal agricultural disaster designation from the Secretary of the United States Department of Agriculture (USDA) due to crop losses caused by drought in the summer of 2001. This designation initiated the qualification process for emergency loans from the USDA. In response to the severe drought conditions experienced by Michigan farmers and agribusinesses in 2001, the Michigan Legislature enacted the Michigan Farm Disaster Relief Program in order to provide zero-interest loans to farmers and businesses, separate from the Federal loan program. Banks and the Farm Credit Services system made 2,600 zero-interest loans under the program, totaling $183.3 million. As of September 30, 2003, 51 loans totaling approximately $13.5 million were repaid, leaving a total of $169.8 million of the loans still outstanding.

Through fiscal year (FY) 2002-03, the program has cost the State's General Fund/General Purpose budget $4.0 million in quarterly interest subsidy payments to banks and approximately $200,000 in lost interest earnings associated with State certificate of deposit investments. The actual future fiscal impact on the State, in total and on an annual basis, will be contingent on the term of each loan issued, the amount of loans repaid each quarter, and the State's rate of return on its short-term investments. Two recent Federal disaster programs made available to Michigan farmers will lower the balances of outstanding zero-interest loans, thereby reducing the cost of the zero-interest loan program to the State.

Michigan Farm Disaster Relief Program

Public Act (P.A.) 16 of 2002 amended P.A. 105 of 1855, which governs the disposition of State surplus funds, to authorize financial institutions to make zero-interest emergency agricultural loans under certain circumstances; established loan criteria and set maximum loan amounts. The total amount of zero-interest loans authorized under the legislation is $210 million, of which up to $10 million is earmarked for agribusiness loans. Financial institutions were authorized to issue the zero-interest loans until October 1, 2002, with a maximum term of five years, not to extend beyond October 1, 2007. The legislation provided a "grace period" whereby repayment of each loan is not required until 24 months after the date of the loan. Although 51 loans were repaid in full as of September 30, 2003, all remaining loans will have made their first of four required repayments by October 1, 2004.

Initially, 29 financial institutions issued 2,600 loans totaling $183.3 million for an average of $70,512 per loan. Farmers received $178.8 million in loans, while agribusinesses received $4.5 million in zero-interest loans. Loans were issued in 70 of the 82 eligible counties. The largest number of loans issued in any single county was 455 in Huron County, where $28.1 million in zero-interest loans were written.

Public Act 16 of 2002 provided financial institutions with two methods of making the zero-interest loans. First, P.A. 16 required the State Treasurer to deposit up to $30 million of surplus funds in financial institutions by May 1, 2002, in order to give them the resources necessary to make zero-interest loans to farmers and agribusinesses. Under this scenario, the State purchased certificates of deposit from the institutions, which in turn used the money to provide zero-interest loans. To cover the administrative costs associated with making the loans, financial institutions were authorized under P.A. 16 to receive an additional reserve investment equal to 20% of the investment received for the loans.

In lieu of using State funds to make the loans, P.A. 16 of 2002 allowed financial institutions that are constitutionally prohibited from accepting State deposits to use their own funds to make zero-interest loans and receive an interest subsidy and reimbursement for the administrative costs associated with making the loans. Under this scenario, the institutions receive quarterly subsidy payments from the State equal to 120% of the State's common cash earnings rate on the money lended. The additional 20% is intended to allow lenders to recover costs associated with making zero-interest loans to farmers and agribusinesses. Under both methods, the financial institutions are required to loan funds at 0% interest and are prohibited from charging fees related to the loans.

Zero-interest loans were capped at $200,000 per individual farmer and $400,000 per agribusiness. A provision in P.A. 16 required the maximum loan amount to be reduced for producers that did not purchase crop insurance for the affected crop, if insurance for that crop was available. Loan amounts ranged from $700 to $200,000 for farmers and $15,000 to $400,000 for agribusinesses.

All loans must be repaid by October 1, 2007. The first loan repayment will be due the last working day of the month in which the loan was made, beginning 24 months after the loan was issued. For example, for loans made in September 2002, the first repayment of 25% of the original loan amount will be due on the last working day of September 2004, with subsequent payments of 25% of the original amount due in September 2005, 2006, and 2007. Public Act 16 of 2002 requires the recipient of a zero-interest loan to pledge any Federal disaster grant toward the repayment of the loan. Zero-interest loan repayments will be affected by two recently enacted Federal disaster programs that provide grants to farmers who experienced crop losses in either 2001 or 2002.

Federal Agricultural Disaster Programs

Responding to agricultural production losses throughout the country in 2001 and 2002, Congress passed, and the President signed on February 20, 2003, the Agricultural Assistance Act of 2003 (Public Law 108-7), authorizing into law two disaster grant programs in which Michigan farmers are eligible to participate. The 2003 Crop Disaster Program (CDP) reimburses producers for crop losses due to damaging weather or related conditions in either 2001 or 2002. This program specifically excludes sugar beet producers, a commodity that Michigan ranks fourth in nationally. To address production losses incurred by sugar beet farmers due to adverse weather in 2001 or 2002, the Agricultural Assistance Act of 2003 also authorized the Sugar Beet Disaster Program. Both programs, administered by the USDA, provide direct grants of up to $80,000 based on crop production losses for either 2001 or 2002, but not both.

Sign-up for the Sugar Beet Disaster Program ended October 31, 2003. A total of $1.7 million was paid out to Michigan producers statewide under this program, with the largest amount ($403,000) distributed in Gratiot County. Under the CDP, sign-up began June 6, 2003, and will extend until January 30, 2004. As of December 4, 2003, the USDA had paid out $41.4 million in grants. Huron County has received the largest amount of grants to date, totaling $4.6 million. It is estimated that CDP grant payments could total between $50 million and $60 million when enrollment is complete.

In general, qualification for the Federal grant programs was more stringent than qualification for Michigan's zero-interest loan program. It is reasonable to assume that a large proportion of zero-interest loan recipients also received a grant from the USDA. As a result of language in P.A. 16 of 2002 requiring assignment of Federal disaster assistance grants toward repayment of existing zero-interest loans, receipt of the USDA payments will reduce the amount of outstanding zero-interest loans and therefore the amount of quarterly interest subsidy payments required of the State. Farmers and agribusinesses will continue to have until October 1, 2007, to repay their loans in full as the Federal grants will be applied to the outstanding balances of the loans as opposed to early repayment.

Fiscal Impact

The fiscal impact of the provision requiring the State Treasurer to deposit up to $30 million in surplus funds with financial institutions will be equivalent to the amount of interest earnings that the State will forgo in order to make this money available for zero-interest loans. These interest earnings would have been revenue credited to the General Fund. According to the Department of Treasury, only three institutions requested State deposits for loans and administrative costs, totaling $6.8 million. As of September 30, 2003, this aspect of the program has cost the State about $200,000 in lost interest earnings. The estimated cost to the State of these deposits is about $600,000 over the five-year loan period.

The other method of providing zero-interest loans allows the State to reimburse financial institutions for the interest and administrative costs associated with making the loans. Under this method, institutions, using their own funds to make the loans, are eligible to receive a payment equal to 120% of the State's earnings on its short-term investments multiplied by the amount of the outstanding loans issued by the financial institutions. As of September 30, 2003, this portion of the program had cost the State $4.0 million in quarterly interest subsidy payments. The actual total cost to the State of both methods for issuing zero-interest loans will be contingent on the length and repayment schedule of the loans issued and the future direction of short-term interest rates. The total cost of the zero-interest loan program also will be reduced as a result of the Federal disaster grants and the requirement to use these payments for loan repayments.

Without the Federal disaster grants, the estimated total cost of Michigan's zero-interest loan program is $19.5 million over the five-year loan period. Factoring in the estimated impact that the Federal grants will have on Michigan's program, the total cost is projected to be between $13.6 million and $15.1 million over the same period, depending on the total amount of Federal grants received by Michigan producers that also participate in the zero-interest loan program. Future Federal agricultural disaster grant programs will reduce further the cost of the zero-interest loan program as a result of the requirements of P.A. 16 of 2002.

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Fire Protection Grants
by Maria Tyszkiewicz, Fiscal Analyst

The Fire Protection Grant program was created in 1978, pursuant to Public Act 289 of 1977. The purpose of the program was to provide payment in lieu of property taxes, to cities, villages, and townships in which State-owned buildings are located, for fire protection services. Funding for this program had been increased during the 1990s, but starting in fiscal year (FY) 2001-02, the grant program was reduced to nearly its original FY 1977-78 level. Table 1, below shows a history of the appropriations for this grant program. In the FY 2003-04 budget, the appropriation is at the estimated fully-funded level based on the FY 2002-03 calculations, but accompanying boilerplate language makes the allocation of $12.1 million contingent upon a statutory change that would affect the deposit in the Liquor Purchase Revolving Fund.

Table 1

Fire Protection Grants
History of Appropriations

FY 1977-78	$3,000,000
FY 1978-79	3,000,000
FY 1979-80	3,000,000
FY 1980-81	Vetoed
FY 1981-82	4,000,000
FY 1982-83	4,000,000
FY 1983-84	4,000,000
FY 1984-85	4,000,000
FY 1985-86	4,000,000
FY 1986-87	4,000,000
FY 1987-88	3,975,000
FY 1988-89	3,975,000
FY 1989-90	6,375,000
FY 1990-91	6,375,000
FY 1991-92	6,375,000
FY 1992-93	6,375,000
FY 1993-94	6,375,000
FY 1994-95	6,375,000
FY 1995-96	6,375,000
FY 1996-97	6,375,000
FY 1997-98	6,535,000
FY 1998-99	6,675,000
FY 1999-2000	6,675,000
FY 2000-01	7,421,000
FY 2001-02	3,710,500
FY 2002-03	3,710,500
FY 2003-04	15,839,000

The statute outlines a formula by which award amounts are determined. The statute requires the Department of Management and Budget (DMB), to establish the value of each State-owned building as of December 31 of the previous year. This is done by multiplying a dollar amount by the square footage of the building. In 1978, when this legislation was enacted, a list of 19 different building types was created. A set amount per square foot was then calculated for each building type. For instance, the amount per square foot for Type A buildings, which include the Capitol, hospitals, and infirmaries, was $80, whereas the amount per square foot for Type B buildings, which include correctional security buildings, was $70. This amount is multiplied by the square footage of the building and an annual depreciation of 1% is applied. The result is used as the building's value. Each year an index is used to compare the amount per square foot to the base year (1978) to determine the increase that should be provided to each building type based on the National Average of Building Costs published in Engineering News. The increase must equal $5 or more for a change to be made to the multiplier.

After the values of the buildings are calculated, they are tallied by the DMB and sent to the Department of Labor and Economic Growth (DLEG) (formerly the Department of Consumer and Industry Services). The DLEG adds the building values to the amount of State-owned inventory, which primarily consists of equipment, by municipality. Half of the total value equates to the State equalized valuation (SEV) of State-owned buildings by municipality. Each municipality also must report to the DLEG the SEV of the municipality as well as the operating budget for the fire department. The DLEG then calculates the percentage of the SEV of the municipality that the State buildings make up, or:

$$\frac{\text{Total SEV of the State Property in the Municipality}}{\text{Total SEV of the State Property in the Municipality + Total SEV of the Municipality}}$$

This percentage is then multiplied by the municipality's fire department budget to determine the formula amount. Because the appropriation for this grant program is a set amount, pursuant to the statute, if the total grant amount is greater than the appropriation, the grants are prorated based on the total appropriations as a percentage of the total formula amount. Any municipality that has a formula amount of $500 or less is not eligible for a grant.

This program was originally funded with General Fund dollars but in the late 1980s the fund source was changed to Liquor Purchase Revolving Fund (LPRF) revenue. Using LPRF funds is essentially the same as using General Fund dollars, as the balance in the LPRF is deposited into the General Fund at the end of every fiscal year; therefore, any appropriation made out of the Fund reduces that deposit.

In FY 2003-04, 54 grants were awarded to local governments, with the minimum grant of $503 going to Fife Lake Township and the maximum grant of $1,019,252 to the City of Detroit. Below Table 2 lists grant recipients under the appropriation amount as compared with the amount that would have been available had the program been fully funded.

Table 2

FIRE PROTECTION GRANTS
FY 2003-04

	Formula Amount	Actual Payment
Township of Adams	$ 732.12	$ 0
City of Adrian	41,472.92	9,979.85
Township of Allendale	66,357.26	15,967.91
City of Alpena	20,583.62	4,953.15
City of Ann Arbor	1,602,993.19	395,737.02
Township of Ann Arbor	36,114.85	8,690.51
City of Auburn Hills	78,057.99	18,783.52
Village of Baraga	12,604.33	3,033.05
Township of Beaver Creek	5,644.47	1,358.26
Township of Benton	31,338.59	7,541.18
Township of Bethany	7,625.85	1,835.05
City of Big Rapids	347,259.91	83,563.01
Township of Blackman	320,291.91	77,073.59
Township of Bloomer	4,605.43	1,108.23
Township of Chocolay	718.12	0
Township of Coldwater	17,230.80	4,146.34
City of Dearborn	130,659.84	31,441.39
City of Detroit	4,235,699.11	1,019,252.21
City of East Lansing	1,920,897.07	462,235.96
City of Escanaba	47,139.22	11,343.37
Township of Fife Lake	2,091.77	503.35
City of Flint	520,100.49	125,154.62
Township of Freesoil	633.82	0
Township of Garden	805.95	0
City of Grand Rapids	295,162.29	71,026.52
Township of Grant	2,191.52	527.36
Township of Grayling	1,991.86	0
Township of Green Oak	6,973.40	1,678.05
Township of Higgins	1,421.52	0
City of Houghton	44,197.51	10,635.49
Township of Indianfields	3,276.12	788.35
City of Ionia	563,265.83	135,541.74
Township of Iron River	721.78	0
Township of Ironwood	696.83	0
City of Kalamazoo	1,339,823.34	322,409.01
Township of Kinross	19,711.02	4,743.17
Township of Kochville	26,555.09	6,390.10
Township of L’Anse	515.50	0
City of Lansing	1,449,046.54	348,691.99
City of Lapeer	26,617.21	6,405.04
Township of Lenox	9,684.61	2,330.46
Township of Lyndon	2,315.48	557.19

FIRE PROTECTION GRANTS
FY 2003-04

	Formula Amount	Actual Payment
Township of Madison	17,965.02	4,323.02
Township of Manistee	4,814.19	1,158.46
City of Manistique	13,496.43	3,247.72
Township of Marenisco	4,438.52	1,068.07
City of Marquette	322,708.66	77,655.15
Township of Meridian	39,985.59	9,621.95
City of Mount Pleasant	490,078.30	117,930.22
Township of Munising	6,208.10	1,493.89
Township of Munro	665.28	0
City of Muskegon	191,016.50	45,965.34
Township of Northville	37,664.20	9,063.34
Township of Osceola	758.94	0
Township of Pentland	15,383.37	3,701.79
Township of Pittsfield	30,473.61	7,333.03
Township of Praireville	3,186.27	766.73
Township of Roscommon	1,769.72	0
Township of Ross	2,367.33	569.66
City of Sault Ste. Marie	256,659.60	61,761.40
Township of Slagle	821.90	0
City of St. Louis	32,258.99	7,762.66
City of Standish	6,326.91	1,522.48
City of Stephenson	545.55	0
Township of Tittabawassee	3,603.16	867.05
Township of Windsor	66,904.96	16,099.71
Township of York	10,550.29	2,538.77
City of Ypsilanti	625,940.60	150,623.51
TOTAL PAYMENTS	**$15,432,387.89**	**$3,710,500.00**

Medicare Prescription Drug Act
by Steve Angelotti, Fiscal Analyst and Dana Patterson, Fiscal Analyst

On December 8, 2003, President Bush signed into law HR 1, the Medicare Prescription Drug Reform Act. This followed the United States Senate's adoption of the conference report on November 25, 2003, and approval the previous week by the U.S. House of Representatives.

The most significant provision of the Act is the creation of a Medicare prescription drug benefit. In the past, Medicare did not cover the cost of medications prescribed outside of a hospital setting. The full benefit will take effect on January 1, 2006, with a discount card being made available to Medicare recipients six months after enactment (June 2004), to ensure that discounts are available for Medicare recipients who do not have other pharmaceutical coverage.

The Act includes numerous provisions affecting other aspects of the Medicare program, provisions affecting the Medicaid program, and provisions relating to other senior-oriented health issues.

The purpose of this memorandum is to examine the effects of the Act on the State of Michigan and State programs, particularly Medicaid and the Elder Prescription Insurance Coverage (EPIC) program.

Effects of the Medicare Prescription Drug Reform Act on Michigan Medicaid Pharmaceutical Expenditures and the Elder Prescription Insurance Coverage (EPIC) Program

The changes to Medicare included in the Act will provide coverage for pharmaceuticals, beginning January 1, 2006, to all Medicare recipients who elect to have such coverage.

The Act also will direct the Medicare system to pick up a portion of the pharmaceutical costs for "dual eligibles" (Medicare-eligible individuals who are also enrolled in the Medicaid program). As noted above, before enactment of this Act, Medicare recipients were not covered for pharmaceuticals. Dual eligibles, those enrolled in both Medicare and Medicaid, do have their prescriptions covered through the State's Medicaid program.

Dual eligibles will not be covered under the Medicare benefit; they will continue to have their prescription costs paid by their respective state's Medicaid program. As part of a compromise made to address concerns of the states, the Medicare program will pick up a portion of the estimated cost of each state's Medicaid dual eligible prescription expenses.

Effects on Medicaid Pharmaceutical Expenditures for Medicare/Medicaid Dual Eligibles

The impact on State expenditures for dual eligibles is fairly clear-cut, at least when compared with other aspects of the program. Starting in 2006, Medicare will pay 10% of the estimated Medicaid pharmaceutical costs for the estimated 180,000 Michigan residents who are projected to be dual eligibles in 2006. That reimbursement percentage will increase by 1 and 2/3rd% each year until 2015 (a provision that has been nicknamed the “claw-back” provision), when Medicare will pay 25% of the Medicaid pharmaceutical costs for dual eligibles.

The adjusted cost used by the Federal government for this estimate will be the fiscal year (FY) 2002-03 estimated General Fund/General Purpose (GF/GP) cost for pharmaceuticals for dual eligibles, adjusted upward by 11%-12% per year to reflect projected increased expenditures. In years after 2006, the estimated cost will be adjusted by growth in Medicare prescription drug expenditures.

The best estimate of State spending on pharmaceuticals for dual eligibles in FY 2002-03 is about $180,000,000 GF/GP. If that amount is correct and is inflated by the assigned amounts of 12.4% for FY 2003-04, 11.7% for FY 2004-05, and 11.1% in FY 2005-06, the base amount will be about $250,000,000 GF/GP. The Medicare program then will pick up 10% of that cost in calendar year 2006, so Michigan will see about a $19,000,000 GF/GP saving in the last three quarters of FY 2005-06. That amount is projected to increase to a full-year amount of $25,000,000 in FY 2006-07.

The portion of estimated dual eligible pharmaceutical costs paid by Medicare will gradually increase over the next nine years to 25% of estimated costs in FY 2014-15, or a base amount of $60,000,000 GF/GP, which will then be inflated by the increase in Medicare prescription drug costs over that period. If costs increased 8% per year from 2006 through 2015, then the Medicare program would pick up about $120,000,000 of the 2015 GF/GP Medicaid pharmaceutical costs for dual eligibles. Over the 10-year period from 2006 to 2015, the State would see total estimated savings of about $650,000,000 GF/GP. Even if the average annual Medicare prescription cost increases were significantly lower, say 5%, the State still would see considerable 10-year savings of about $550,000,000 GF/GP.

One concern that has been raised by some parties is whether the Medicare pharmaceutical program’s ban on rebates would apply to dual eligibles currently served by Medicaid. This could have the effect of eliminating over half of the State’s rebate revenue at the cost of about $40,000,000 GF/GP per year. At present, there is no clear evidence to support this concern, but it merits watching.

Effects on the EPIC Program

The Act creates a Medicare prescription drug coverage program effective January 1, 2006. Before 2006, there will be a limited prescription drug benefit that will have a major impact on EPIC. The following discussion looks at the 2004-2005 effects as well as the long-term effects on EPIC.

<u>Changes for 2004 and 2005</u>

All Medicare beneficiaries will receive Medicare-endorsed pharmaceutical discount cards beginning six months after enactment (June 2004) until the implementation of the Medicare drug benefit on January 1, 2006. One of the advantages of the card will be bulk purchasing discounts available to those who use the card. This is not likely to have a major impact on the

EPIC program (or for Medicare/Medicaid dual eligibles) as the State already aggressively pursues discounts and rebates.

The other major change due to the discount card will be coverage of up to $600 per year for those under 135% of the Federal poverty level. Eligible beneficiaries will pay 5% coinsurance if they are under 100% of the Federal poverty level; 10% if they are between 100% and 135% of poverty.

Currently, EPIC covers about 15,000 people, of whom about 10,000 are under 135% of poverty. Various attempts at cost and cost distribution modeling based on EPIC data provided by the Department of Community Health indicate that most EPIC users but not all spend at least $600 per year, with an estimated average saving to the State of $560 per person per year. This means that having the first $600 covered would save the State about $5,600,000 in EPIC costs if the discount card savings may be applied retroactively to all FY 2003-04 costs. (If not, the savings would be about $1,500,000 in FY 2003-04 before growing to $5,600,000 in FY 2004-05.) If those savings were used to expand the program, an additional 4,000 individuals could be covered full-year at an average cost of $1,400 per person ($1,400 being the expected average cost after taking into account the fact that most of these individuals would qualify for the $600 per person coverage).

This ability to expand the covered population by 4,000 people pales in comparison to the ability to expand if the State's currently pending Medicaid Pharmacy Plus waiver is approved. That waiver would allow Medicaid match dollars to be used to cover individuals and would stretch the current $30,000,000 in Tobacco Settlement revenue to over $68,000,000, effectively allowing for a doubling of the covered population.

Changes in 2006 and Beyond

The implementation of a Medicare pharmaceutical benefit on January 1, 2006, will have a major impact on EPIC. This program was designed to be a "Medigap" insurance coverage for seniors under 200% of poverty. Due to budgetary constraints, EPIC does not cover all seniors under 200% of poverty, but rather is focused on those individuals formerly served by the Michigan Emergency Pharmaceutical program and the Senior Prescription Drug Tax Credit.

Language in the EPIC statute allows the program to be altered to reflect any Federal Medicare drug benefit, by picking up costs not covered by the drug benefit. (Section 9 of the EPIC statute states, "If the federal government establishes a pharmaceutical assistance program that covers EPIC eligible seniors under medicare or another program, the EPIC program shall cover only eligible costs not covered by the federal program.")

There are five separate groups that will be affected by both the Federal Medicare benefit and any changes to EPIC:

1. People under 135% of poverty with less than $6,000 in assets (single) or $9,000 in assets (couple)

These individuals will face only co-pay costs ($2 on generics, $5 on brand names) and no other costs. The EPIC program will no longer need to cover these individuals. Various income and asset data collected over time indicate that about two-thirds of the EPIC-eligible individuals who are under 135% of poverty will meet the asset requirements. This means that of the 10,000 or so EPIC recipients under 135% of poverty, the State will no longer need to pay pharmaceutical costs for two thirds of them.

2. People between 135% and 150% of poverty with less than $10,000 in assets (single) or $20,000 in assets (couple)

These individuals will face co-pays and a $50 deductible, and will be required to cover 15% of costs up to the roughly $5,000 catastrophic coverage limit. Thus, their costs may be up to $750 per year plus co-pays. Various income and asset data indicate that about half of the EPIC-eligible individuals between 135% and 150% of poverty will meet the asset requirements. This means that of the 5,000 or so EPIC recipients between 135% and 150% of poverty, half will have pharmaceutical costs capped at $750 per year. The Senate Fiscal Agency's (SFA's) modeling indicates that the average out-of-pocket pharmaceutical cost for these individuals under the Medicare benefit will be $250 per year. The EPIC program could be redesigned to cover part or all of that cost. Covering an average of $250 for 2,500 individuals would cost $625,000 per year, far less than the current estimated $4,000,000 per year spent by EPIC on those between 135% and 150% of poverty who meet the asset requirements.

3. People under 135% of poverty who do not meet the asset requirements

These individuals, about one third of the population under 135% of poverty, will have the regular Medicare drug benefit, not the enhanced benefit.

4. People between 135% and 150% of poverty who do not meet the asset requirements

These individuals, about one half of the population between 135% and 150% of poverty, will have the regular Medicare drug benefit, not the enhanced one.

5. People between 150% and 200% of poverty

These individuals will have the regular Medicare drug benefit.

Cost Structure for Those with the Regular Medicare Drug Benefit

The Medicare drug benefit includes a $250 deductible, an estimated $35 per month ($420 per year) premium, $2 co-pays for generics and $5 co-pays for brand names, and full coverage up to $2,200 per year. After that point, the so-called "donut" takes effect, and costs are not covered until the covered person has spent a total of $3,600 on the deductible, on premiums, and on co-pays. After that point, achieved at roughly $5,000 in drug costs, catastrophic coverage (with 5% cost-sharing) kicks in.

The EPIC program, which covers all costs beyond a $25 application fee and a sliding scale 1%-5% co-pay, could be restructured to cover some of the costs not picked up by the Medicare drug benefit. The structure would have to be determined and could be directed by the Legislature through changes to the EPIC statute or through boilerplate.

For instance, the EPIC program could cover costs between $2,200 and $5,000 per year (the so-called "donut"), but not the deductible, premiums, or co-pays. Based on the data reported to the Department and modeling done by the SFA, that approach would have an average cost of $500 per eligible individual. Presumably, many would not elect to have EPIC coverage as three-fourths of the individuals who could be covered would not exceed $2,200 in pharmaceutical costs. One can confidently state, however, that the $38 million available if the Pharmacy Plus waiver goes through could guarantee no "donut" problems for 76,000 potential eligible individuals ("eligibles").

Another approach would be for the EPIC program to cover the premiums and costs between $2,200 and $5,000 per year, while keeping the $250 deductible and the co-pays as the client's responsibility. That would lead to an average cost of about $920 per year ($500 plus the $420 annual premium). Under this system, eligible people likely would accept EPIC coverage because they would have their premium costs covered, so about 40,000 potential eligibles would seek coverage and would be able to avoid both premiums and "donut" problems.

The next question is, how many people under 200% of poverty are not covered by private insurance, are not on Medicaid, and are not enrolled in EPIC? In other words, what is the potential universe of EPIC clients if the program is revamped and the covered population expanded?

Based on income data reported to the Federal government, the SFA estimates that there are about 300,000 seniors in Michigan who are under 200% of poverty and are not on Medicaid, of whom 130,000 likely have pharmaceutical coverage either through private insurance from their former employer or due to meeting the asset/income requirements for nearly complete Medicare pharmaceutical coverage. This leaves 170,000 potential clients.

Of these, about 5,800 would be EPIC participants under 150% of poverty who, due to not meeting the asset requirements, would not receive nearly complete Medicare pharmaceutical coverage. Restoring coverage akin to EPIC (with costs similar to the application fee and co-pays) would cost about $800 per client, or about $4,600,000 per year.

The remaining 164,200 potential clients under 200% of poverty could be covered under a Medigap approach. As noted above, full coverage of the "donut" would cost on average $500 per person per year, or about $82,100,000 in total. Coverage of the "donut" and the monthly premiums would cost about $920 per person per year or about $151,000,000 in total.

It appears that approximately 75,000 potential clients under 150% of poverty would seek coverage under a Medigap approach. Full coverage of the "donut" at the above-noted average of $500 per person per year would cost about $37,500,000. Coverage of the "donut" and the monthly premiums at $920 per year would cost about $69,000,000.

If the Pharmacy Plus waiver is approved, the EPIC program, without any other funding changes, will have about $63,500,000 to spend after those between 135% and 150% of poverty regain coverage similar to EPIC. This $63,500,000 would allow coverage for three quarters of the individuals under 200% of poverty if the "donut" is covered but the deductible and premiums (or up to about 180% of poverty) are not. If the monthly premiums were covered as well, a combined EPIC/Medicare coverage could be provided to all those under 150% of poverty at only a minimal increase in cost.

If the Pharmacy Plus waiver is not approved, the EPIC program, absent any other funding changes, will have $30,000,000 available, or about $25,400,000 to spend after those between 135% and 150% of poverty regain coverage similar to that enjoyed under EPIC. This $25,400,000 would allow coverage for about 30% of those under 200% of poverty if the "donut" were covered but the deductibles and premiums (or up to about 140% of poverty) were not.

It should be noted that these are very rough estimates, based on population, income, and expenditure data from multiple sources. It should further be noted that these estimates are based on mathematical modeling using actual EPIC data. Thus, each of the estimates on eligible populations, costs per client, and overall costs may be described as a midpoint best-guess estimate. Before any revisions to EPIC take place, one assumes that an effort would be undertaken to estimate costs in a more rigorous fashion.

Medicaid Disproportionate Share Hospital (DSH) Provision

The Act includes a provision increasing each state's DSH limit by 16%, with an additional provision allowing continued increases in the DSH limit for low DSH states (a provision that will not apply to Michigan).

At the present time, Michigan is in danger of exceeding its DSH ceiling unless Adult Benefits Waiver (ABW) part I is approved by the Center for Medicare and Medicaid Services (CMS). Verbal approval was granted, but final written approval has not been given, so the waiver is still on hold. The danger is that the State will be liable for about $50,000,000 GF/GP due to exceeding the DSH ceiling if the waiver is not granted. The 16% provision will eliminate most of this potential problem. If ABW part I is approved, the higher DSH ceiling will allow for increased Medicaid special financing, with potential savings of $40,000,000 GF/GP, which would help offset the rather large Medicaid shortfall in the FY 2003-04 budget.

Demonstration Projects on Background Checks for Long-Term Care Employees

The Act includes language establishing a two-year $25,000,000 demonstration project for 10 states to fund background checks for long-term care facility employees. Michigan already does background checks, through the State Police and the Department of Consumer and Industry Services (now within the Department of Labor and Economic Development). It is not clear whether Michigan will be able to avail itself of these funds as only 10 states will be eligible, but it is a provision that could work to the State's advantage both in terms of finances and in terms of protecting those in long-term care facilities.

Emergency Health Services for Undocumented Immigrants

The Act appropriates $167,000,000 per year to the 50 states in proportion to each state's share of undocumented immigrants residing in that state. It is not clear how much money Michigan will stand to gain from this provision, although some general surveys indicate that approximately 1% of the nation's undocumented immigrants reside in Michigan. This would translate to $1,670,000 per year in Federal funding that could be distributed to providers to cover uncompensated care for emergency health services to undocumented immigrants.

Subsidy to Cover State Retirees' Prescription Costs

Many employers cover the prescription costs of retirees. One of the concerns about the Medicare proposal is that it will lead to employers' dropping coverage for their retired employees. In order to avert this possibility, the Act includes a subsidy that will cover 28% of allowable Medicare-eligible retiree costs above the $250 deductible up to $5,000.

By 2006, the State should have about 30,000 retirees who are Medicare-eligible. Typical pharmaceutical expenditures for seniors are in the range of $1,500 per year, so a 28% subsidy of costs above the $250 deductible (capped at $5,000) will save the State an average of $300 per retiree. Total savings to the State's retirement system are projected to be approximately $9,000,000 per year.

Overall Impact

The implementation of the Medicare Prescription Drug Reform Act will have a positive impact on the State of Michigan's finances. None of the major provisions will increase State costs above what they would have been absent passage of the Act; instead, all of the provisions will reduce costs. The final implementation of the benefit in January 2006 will give the State an opportunity to expand the EPIC program greatly without any additional cost. The State will see major savings from the so-called "claw-back" provision for Medicare/Medicaid dual eligibles. There is the possibility of restrictions on rebate revenue that will merit careful examination of regulations related to the program. The increase in the DSH ceiling will, at minimum, prevent a major cost increase in case the Federal government does not approve the Adult Benefits Waiver part I. Finally, the State will see savings to its retirement system.

Impact of the Medicare Prescription Drug Reform Act - Summary Table

State Expenditures for Medicaid Dual Eligibles	The State will see nine-month savings of $19,000,000 GF/GP in 2006 ($25,000,000 GF/GP full-year), increasing to about $100,000,000 to $120,000,000 GF/GP by FY 2014-15, when Medicare will pick up 25% of Michigan's dual eligible pharmaceutical costs.
Elder Prescription Insurance Coverage (EPIC) Program	• In 2004 and 2005, the State will save $5,600,000 annually due to the $600 per year savings from the discount card for those under 135% of poverty. If payments for expenditures before implementation in June 2004 are not covered, then FY 2003-04 savings will be about $1,500,000. • In 2006 and beyond, the elimination of almost all pharmaceutical costs for those seniors under 150% of poverty who meet asset requirements will save the State $16,000,000 per year, assuming no EPIC expansion. • Expansion of EPIC to serve as Medigap coverage would cost an average of $500 per person per year if the costs between $2,200 and $5,000 were covered, and $920 per person per year if the $35 per month premium also were covered.
Disproportionate Share Hospital (DSH) Payments	Increasing the State's DSH limit by 16% will save about $40,000,000 GF/GP per year *if* the additional DSH financing is used for increased Medicaid special financing. If Adult Benefits Waiver (ABW) part I is not approved, the State will be $50,000,000 GF/GP over its DSH limit and the additional $40,000,000 will reduce, but not eliminate, the problem.
State Retirees' Prescription Costs	The 28% subsidy of costs between $250 and $5,000 will save, on average, about $300 per year per retiree. Assuming 30,000 Medicare-eligible retirees in 2006, this means annual savings of $9,000,000 per year.
Overall Impact	• Total potential savings in FY 2003-04, assuming no expansion of EPIC, will be between $41,500,000 and $45,600,000 GF/GP or GF/GP equivalent if the additional DSH money is used for special financing and if ABW part I is approved. Without approval of ABW part I, the FY 2003-04 savings will be nominal. • Total potential savings in FY 2005-06 will be $84,000,000 GF/GP or GF/GP equivalent if the additional DSH money is used for special financing and if EPIC is not expanded.

While precise estimates will be difficult to make before better data are obtained, a round estimate of annual savings in 2006 and beyond, assuming no policy changes, of over $80,000,000 GF/GP per year is quite reasonable, and it is reasonable to predict that savings will increase over time. This estimate, however, is based on the assumption that no policies are changed, that ABW part I is approved, that no restrictions on current rebates are enacted, and that the EPIC program will not be expanded. If ABW part I is not approved, rebates are restricted, or the EPIC program is expanded, then the net savings will be reduced.

Senate Fiscal Agency

State Notes

TOPICS OF LEGISLATIVE INTEREST

November/December

Michigan Child Support Enforcement MiCSES–Update
by Constance A. Cole, Fiscal Analyst and Bill Bowerman, Chief Analyst

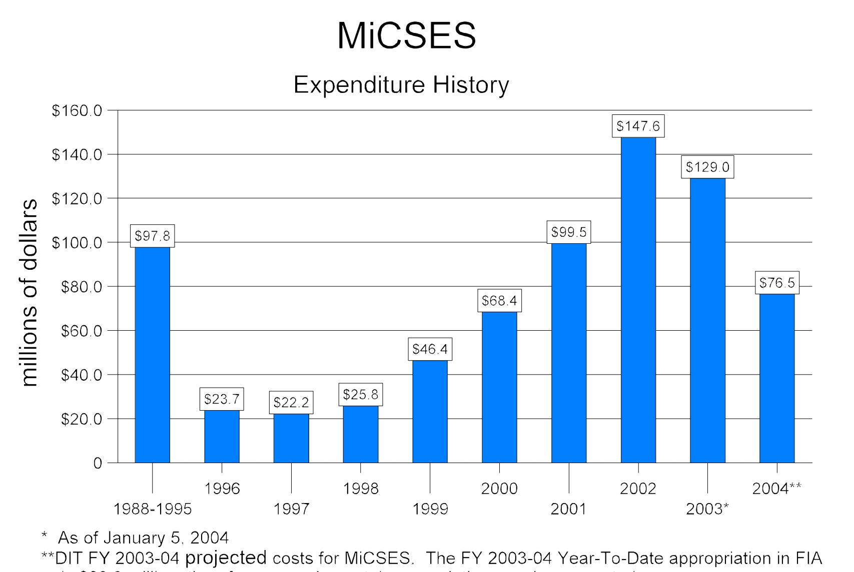
Introduction

Michigan has undergone a very long and expensive process in achieving compliance with the Federal mandate that states implement and operate an automated statewide child support enforcement system, pursuant to the Federal Family Support Act of 1988 as amended by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. The State of Michigan Child Support Enforcement System (MiCSES) was deployed statewide on September 30, 2003, and certified on November 25, 2003; however, the State still must achieve a process of system operation that meets the needs of all the users of MiCSES. The following article provides an overview of MiCSES.

Development and Implementation

Through fiscal year (FY) 2001-02, Michigan spent approximately $531.4 million on development, implementation, and operation of MiCSES as illustrated in Figure 1. The estimated expenditures for FY 2002-03 were approximately $129 million, for a total of $660.4 million spent from FY 1987-88 through FY 2002-03 on the MiCSES for such costs as State and contracted development, maintenance and operations, MiCSES hardware and equipment, staff, rent, and utilities.

Figure 1



* As of January 5, 2004
**DIT FY 2003-04 projected costs for MiCSES. The FY 2003-04 Year-To-Date appropriation in FIA is $68.0 million; therefore a supplemental appropriation may be requested.

Source: Family Independence Agency, Office of Child Support and Department of Information Technology.

Fiscal Year 2003-04 Department of Information Technology (DIT) projected costs for MiCSES are estimated at $76.5 million.[1] Projected expenditures include an estimated 221.0 positions and $26.5 million associated with staffing for project management, application development, infrastructure and systems support, testing, implementation/training, business analysts, business operations, end user computing, and other support functions. The staffing is down from the 506 positions included in FY 2002-03 during the conversion to MiCSES. Other costs included $15.4 million for hardware, software, and equipment maintenance; $33.8 million for contractual services, supplies, and materials (including vendor costs); and $450,000 for site preparation. The FY 2003-04 year-to-date Family Independence Agency (FIA) appropriation includes $68 million to be transferred to the DIT.

Due to the failure of the State to achieve Federal certification by the original deadline of October 1, 1995, penalties assessed against and paid by the State totaled approximately $68.7 million for FY 1997-98 through FY 2000-01. Due to certification by November 25, 2003, the State received a refund of $34.8 million (90% of the penalties paid in FY 2000-01); therefore, the net penalty paid by the State was $33.9 million.

Section 313(3) of Public Act 155 of 2003 (FY 2003-04 Judiciary appropriations) appropriated the first $6 million of the penalty refund to the Judiciary for deposit into the Judicial Technology Improvement Fund. A portion of the $6 million appropriation (not less than $1 million or more than $2 million) is earmarked for the development and operation of a cyber court system. The Judicial Technology Improvement Fund was created in FY 2001-02 to provide funding for the development of a statewide judicial information system. The Fund may also provide grants to local trial court funding units to encourage technology innovations by local trial courts.

After the $6 million allocation to the Judiciary, $28.8 million of the Federal refund was appropriated in the FY 2002-03 and FY 2003-04 FIA appropriations under Section 413. Approximately $8.8 million for MiCSES was spent in FY 2002-03. In FY 2003-04 approximately $6.5 million was vetoed by the Governor and $9.6 million was used in the supplemental appropriation, Public Act 237 of 2003, to restore $11.6 million in Executive Order 2003-23 reductions to the MiCSES appropriation.

According to the FIA, there have been many problems with the implementation and operation of MiCSES, including changes in contractors and strategies. The problems experienced by Michigan during the conversion to MiCSES were similar to problems other states faced during their conversion process; as a result of MiCSES being unavailable or "down" during conversion, some support checks were late and data entry was delayed. The number of users of MiCSES and the size of the caseload also have added to the difficulty of implementing the new system required by the Federal government. The statewide child support program includes FIA Office of Child Support (OCS) operations (central and regional offices), 65 local Friend of the Court offices, 83 county prosecuting attorney offices, and the Department of Attorney General. There are approximately 2,600 child support professionals in those offices using MiCSES. According to Annual Statistical

[1]This amount does not include the cost of the State disbursement unit that provides the central location for the receipt and disbursement of certain child support payments pursuant to the Federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996.

Reports of the State Court Administrative Office, in 2001 the statewide total caseload for the Friend of the Court was 812,631. In the circuit courts of the State, during the same year there were 25,810 divorce cases with children filed, and 20,501 new paternity cases. These offices had to learn the use of and accept a new model developed to assure accountability through solving problems with processing and correctly distributing support payments, ensure the ability to enter and enforce court orders, improve case management, and track down noncustodial parents.

Status and Performance

The MiCSES has been installed in all of the State's 83 counties; all child support cases are now contained in a single statewide data base. This conversion was accomplished on a fast track in order to meet Federal requirements. As a result, MiCSES was not developed with the advantage of user testing and input to correct MiCSES problems in maintenance and operations. These problems include child support caseload conversion backlogs, case payer and payee duplications, and other customer service issues regarding support collections and payments (as mentioned above), interstate caseload issues related to data matches, and attorney and employer searches that may impede support case referrals, collections, payments and appropriate court action.

Improvements to MiCSES are necessary to alleviate these problems. Continued staff training and other support are necessary to ensure that MiCSES is an efficient operation, and that MiCSES functionality of applications and operation maintenance are ensured through the reduction of data conversion problems and human errors. The FIA and DIT point out that the MiCSES is not only a revenue generating, but also a cost-avoiding operation for the State. The Federal child support incentive payments are earned by the State's successful program performance, and collections reduce families dependence on State and Federal aid. According to a MiCSES project update, the State will receive approximately $30 million in incentive payments because it successfully met program performance criteria measured in FY 2001-02. The OCS expects that FY 2002-03 incentive payments will be less than in FY 2001-02 as a direct result of the system conversion and the economy. However, it is anticipated that the State will exceed the FY 2002-03 performance level in order that additional incentive payments may be earned in FY 2003-04. Therefore, it is important that these issues be addressed and MiCSES functionality problems alleviated.

Conclusion

The priority of MiCSES is to provide the support that the State's families need: to increase the receipt of support payments and give families a leg up toward self-sufficiency. The OCS, county Friend of the Court offices, county prosecuting attorney offices, and the DIT have identified the level of MiCSES supports necessary for maintenance operation and to correct existing problems. A new vendor, Accenture, replaces the former vendor, Policy Studies, Inc. The contract includes a 90-day transition period to enable the two vendors to work together for a smooth operation transition including any corrective action, in order to reduce the likelihood of future processing errors and provide needed staff support, such as additional training and on-site supports.

Footnote: The authors thank the Office of Child Support and the Department of Information Technology for providing information for this article.